Themes from FIM

"China + 1, but which +1 leader is best?" *06 September 2023*

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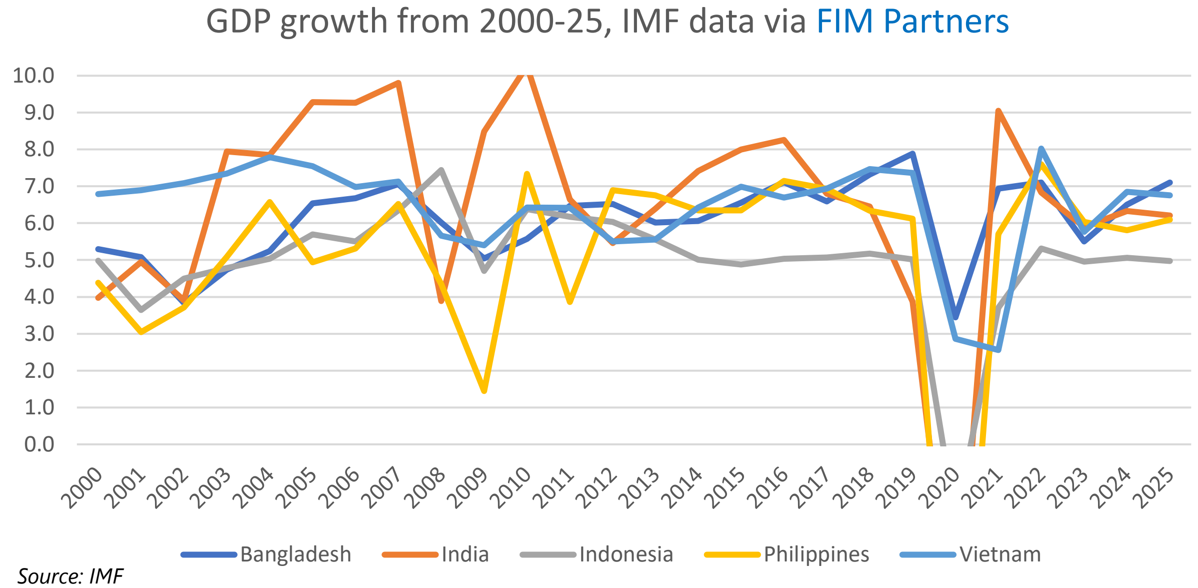
The biggest question facing most big multi-national companies today, even Chinese companies, is where to re-shore at least some of their China-based production. For Western companies, this is driven by geopolitical anxieties, as Biden's America proves to be just as wary of China as Trump's America. No business wants to get caught up in a trade war, or worse still in a Russia-style conflict or sanctions situation. For Chinese companies, a shrinking local workforce means they have to either move up the value-added curve and invest in robots, or move out, much like Japanese companies who diversified to cheaper labour options in Thailand or China in the late 20th century. Here we focus only on Asian options, with plentiful cheap labour.

Who should be chosen?

Choosing a "+1" is a tough call unless you are Ken looking for Barbie in this summer's box office hit. Is it communist one-party state Vietnam, which might feel like swapping one similar risk for another? Is it Indonesia with 275m people spread out over a country whose geographic span is equivalent to Portugal from Dubai? English-speaking Philippines is attractive but with 7,640 islands it might carry some logistical challenges. For others, including Apple manufacturer Foxconn[1] the answer is India though it does have its challenges. Former French president Charles de Gaulle said it was impossible to govern a country with 264 cheeses, imagine what he might say about doing business in a country with more than 2,000 minimum wages.



Source: IMF

The pre-requisites

Our answer is that it really doesn't matter, because they are all good choices, for the same key reasons. To become a successful and sustainable manufacturing economy, there are three pre-requisites and the 2 billion people of Bangladesh, India, Indonesia, the Philippines and Vietnam deliver on each.

First 70-80% adult literacy is needed, because only a literate garment worker knows to put Levi jeans into the box marked "Europe" instead of "America" (as a Levi's manufacturer in the Philippines explained to me). The reason China became a manufacturing powerhouse in the 1990s, while "Made in India" was unrealistic until the 2010s, was because China got to 70-80% literacy 25 years before India[2].

Second electricity is needed. The Philippines could not use its literacy and language advantage to build a big manufacturing base in the 1990s, and so only grew at 2.8% pa, because the country could not supply plentiful, cheap and reliable electricity to industry[3]. Today it can.

Third, it really helps to have a fertility rate below three, because of the double demographic dividend effects we noted in our [first Themes from FIM](). Slower population growth fuels faster local savings growth. This allows infrastructure to be built, from cheap electricity to roads and ports, that then makes countries attractive for foreign direct investment (FDI). Not much manufacturing FDI goes to high fertility countries.[4]

The graph above shows how strong and consistent GDP growth is in all these countries, now that they meet these prerequisites. The IMF estimates GDP growth over 2000-25 will have averaged 5% in both Indonesia and the Philippines (perhaps islands are a bit of a challenge), 6.1% for Bangladesh, and 6.4% for India and Vietnam. Bangladesh exports as much per capita as India, and Vietnam already exports far more per capita than China.

The controversial conclusion

The controversial conclusion from this, is that leadership doesn't matter half as much as consensus assumes it does. I have lost count of how many times I've heard that a country's high growth is driven by its current good leadership or its good institutions (the Why Nations Fail thesis). What the data above implies is that if the structural conditions are in place to boom, then any leader is going to look good, whether they are India's PM Narendra Modi or the former populist president of Philippines, Rodrigo Duterte. The implication is that it doesn't much matter who wins either India's or Indonesia's presidential elections in 2024. These economies will boom anyway, although each will have bumps in the road (and India does look at risk of overheating in the next year or two).

Key takeaway

This is not to say that leadership never matters. There are always a few leaders who can snatch defeat from the jaws of development victory – just look at Venezuela. And some are far-sighted enough to deliver impossible success, such as Lee Kwan Yew with Singapore, a city state that few felt was viable in the 1960s.

Our key message is that just like most of Europe that got rich even though no-one can remember the leaders who made this happen in Sweden, Belgium, Italy, the Netherlands and Spain, so will ASEAN and south Asian countries in the coming decades. FDI moving from China will help turbo-charge that growth.

Implications for investors

No wonder then that equity investors price India's shares so highly and SE Asia is just as interesting. The globalisation play is powerful in itself, lifting logistics operators like Gemadept in Vietnam whose share price has doubled since 2019. It also feeds the bottom-up story too, as it helps countries power through the $5,.000 per capita GDP level that fuels domestic consumption[5]. The positive structural situation also hints at long-term real appreciation of currencies as countries move up the value-added curve from rural subsistence farming to better paid manufacturing jobs that are globally competitive. Credit ratings tend to improve with high growth, rising per capita GDP and more FDI financing current account deficits (if there are deficits). We saw rating upgrades in Vietnam last year[6] and Indonesia may be due for some upgrades in the medium-term too. The challenge for investors is watching for over-exuberance from economic success and being active enough to *temporarily* pare back positions over the coming decades.

Source: 1) Bloomberg, 2) UNESCO, 3) IEA, 4) UN, 5) Morgan Stanley, 6) Moody's and S&P

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